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02-05-08

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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of
SAN JOSE WATER COMPANY
(U 168 W) for an Order Approving
the Sale of the Main Office under
Section 851 and Authorizing the
Investment of the Sale Proceeds
under Section 790.

Application 07-01-035
(Filed January 22, 2007)

**SAN JOSE WATER COMPANY'S REPLY BRIEF
TO THE OPENING BRIEF OF
THE DIVISION OF RATEPAYER ADVOCATES**

PATRICIA A. SCHMIEGE
LAW OFFICE OF PATRICIA A. SCHMIEGE
705 MISSION AVENUE, SUITE 200
SAN RAFAEL, CALIFORNIA 94901
TELEPHONE: (415) 458-1605
pschmiede@schmiegelaw.com

February 5, 2008

San Jose Water Company's Reply Brief to the Opening Brief of the Division of Ratepayer Advocates is being filed today, February 5, 2008, pursuant to an extension of time for filing and service granted yesterday (February 4, 2008) by the assigned Administrative Law Judge Richard Smith.

I. INTRODUCTION

In its Opening Brief, the Division of Ratepayer Advocates (DRA) presents the Commission with its four major contentions in this proceeding: *FIRST*, to the extent that San Jose Water Company (SJWC) needs additional office space, such space can be provided through a combination of remodeling the Main Office at 374 West Santa Clara Street and leasing a portion of the first floor of the office building located at 1265 Bascom Avenue, San Jose; *SECOND*, when various solutions to SJWC's need for office space are analyzed by modeling the net present value of the revenue requirements of each scenario, the base case recommended above is the least cost alternative; *THIRD*, that the Commission should penalize SJWC for violating Rule 1.1 (Ethics) of the Commission's Rules of Practice and Procedure by allegedly misleading the Commission concerning a material fact to this Application; and *FOURTH*, that the Commission should void five specific land sales as violative of Section 851 of the Public Utilities Code. As will be shown below, each of DRA's four contentions are anchored to factual

errors, mistaken reasoning and poor judgment. Thus, DRA's analysis is wrong, DRA's conclusions miss the mark, and DRA's recommendations are without merit.

For the reasons set forth in SJWC's January 25, 2008 Opening Brief, the Commission should grant SJWC the relief it requests in its Application.

**II. DRA'S SPACE ANALYSIS DOES NOT CONSIDER THE
CONSTRICTIONS PLACED ON THE MAIN OFFICE BUILDING.**

Logic would dictate that before an expert would analyze which is the least cost option to solve a problem, the expert would analyze whether, in fact, a problem even exists in the first instance. If the expert finds that a problem exists, the expert would next consider various solutions to the problem. The expert would then select the most feasible and reasonable solutions for further evaluation. After choosing the appropriate methodology to compare the selected alternate solutions to the problem, the expert would conduct his or her technical analysis. This analysis would identify for the expert which of the possible solutions to the problem is the "best" and thus should be endorsed as his recommended course of action.

It does not appear that DRA followed this logical framework in this case. From the order of its presentation, both in its direct testimony (Exhibit DRA-1)

and in its Opening Brief, DRA presents its “Financial Analysis” before it presents its “Space Requirements.” This backward thinking allows DRA to pick and choose amongst the items in each of the possible solutions to the space problem (the real estate scenarios) in order to demonstrate that there is no office space “problem” in the first instance. The Commission should not be confused by DRA’s undisciplined approach.

It is clear from the evidentiary record that DRA relies on SJWC’s factual analysis of its current office space inventory, the physical layout of that office space, and SJWC’s office space needs -- both currently and into the near future. DRA did not present any independent analysis of SJWC’s office space or employee headcount. While DRA disparages SJWC’s Application as being motivated by the space needs of “six new employees hired after its last GRC and future growth,” DRA Opening Brief at pp. 1, 2, DRA nonetheless accepts that the total office space that SJWC needs is 65,880 square feet.

DRA recommends that SJWC solve its space needs, in part, by “renovating its current Main Office building.” Yet DRA does not respond to any of SJWC’s testimony concerning the near impossibility of renovating the Main Office building so as to accommodate SJWC’s office needs, let alone the sizeable costs that would be incurred in any renovation of the Main Office. *Not* a single sentence of DRA’s Opening Brief addresses the feasibility or practicality of

renovating the Main Office building. As SJWC summarized at pages 9 through 11 of its Opening Brief, the record evidence shows that renovating and remodeling the Main Office to suit SJWC's office space needs is impossible.

In addition to basing its space requirements analysis on the assumption that the Main Office can be renovated, DRA then finds additional office space either through a lease of the first floor of the 1265 Bascom Avenue building, or through space "freed up at 1251 Bascom Avenue when the store items are moved to Will Wool." DRA Opening Brief at p. 2. But DRA errs in arguing that additional office space will be made available at 1251 Bascom Avenue in the "Base Case" scenario. Office space will be created at 1251 Bascom Avenue *only* in the Alternative 1 and Alternative 2 real estate scenarios, not in the Base Case. Compare SJWC Stein, Ex. SJWC-1, attached exhibit 5 (page 10 of 39) versus exhibit 9 (page 23 of 39).

DRA errs again in arguing that SJWC's proposed Alternative 2 would "result in extremely low occupancy of space." DRA Opening Brief at p. 18. To create this argument, DRA simply takes the total square footage of the new building on Taylor Street and divides it by the total number of employees that will initially occupy the building. DRA thus derives the meaningless assertion that each employee will occupy 757 square feet of office space in the new building. The error in DRA's thinking is obvious -- DRA ignores that portions of

the total gross square footage of the Taylor Street building will be devoted to hallways, restrooms, stairwells, for example. In fact, DRA entered into the evidentiary record SJWC's data request response on space utilization per employee planned for the new building. Exhibit DRA-4, SJWC's response to data request RK-7, proves that SJWC will follow the industry norms in providing office space to its employees.

For all of the above reasons, and the reasons set forth in SJWC's Opening Brief, the Commission should disregard DRA's analysis of SJWC's office space needs.

III. DRA USES THE WRONG METHODOLOGY TO ANALYZE THE LEAST COST REAL ESTATE ALTERNATIVE.

SJWC addressed DRA's financial analysis on pages 13 and 14 of its Opening Brief. Nothing in DRA's Opening Brief is new. The major disagreement between SJWC and DRA is whether the traditional cash flow analysis that SJWC used is the proper method to analyze Alternatives 1 and 2, or whether DRA's novel approach of looking at the annual revenue requirement over the life of each real estate Alternative is correct. SJWC respectfully submits that DRA's use of revenue requirement to "select" the least cost real estate option is flawed.

Having applied the correct methodology to select the least cost real estate option, SJWC selected to pursue Alternative 2. Therefore, SJWC calculated the revenue requirement of Alternative 2, in order to determine the rate increase necessary to implement Alternative 2. Unable to justify the use of a “revenue requirement” analysis as the first step in selecting the least cost real estate alternative, DRA resorts to highlighting four “supposed” errors that SJWC made in calculating the revenue requirement needed to implement Alternative 2. DRA’s argument is of no moment.

What is most important, in the first instance, is selecting the real estate project that is the least cost option to solving SJWC’s office space needs. SJWC has done so correctly, and that least cost option is Alternative 2. None of DRA’s supposed criticisms are directed to the cash flow analysis.

With respect to DRA’s criticisms of SJWC’s calculation of revenue requirement, SJWC submitted rebuttal testimony refuting each of DRA’s arguments. For example, SJWC did not use the wrong net-to-gross multiplier. The calculation of revenue requirement in this Application is similar to a rate base offset, and SJWC followed Commission precedent in that regard. *See* Exhibit SJWC-8 and October 2007 Standard Practice U-27-W, submitted on January 3, 2008 by DRA witness Han.

Moreover, SJWC witness Palle Jensen testified that a strict timing requirement exists in order for SJWC to consider deferred taxes from a 1031 property exchange. If the Commission grants SJWC authority to complete its sale of the Main Office building to Adobe Systems in sufficient time to take advantage of the benefits of the exchange with the Taylor Street property purchase, SJWC will do so, thereby reducing revenue requirement to the ratepayers benefit.

For the above reasons, and the reasons set forth in SJWC's Opening Brief, the Commission should disregard DRA's financial analysis. Alternative 2 is the least cost and best real estate option for addressing SJWC's office space needs.

IV. SJWC HAS NOT VIOLATED ITS ETHICAL DUTIES TO THIS COMMISSION, JUDGE, AND STAFF.

DRA argues in its Opening Brief that SJWC violated Rule 1.1 of the Commission's Rules of Practice and Procedure when SJWC purchased the building located at 1265 Bascom Avenue in late May 2007. DRA is wrong for many reasons.

DRA mistakenly asserts that SJWC's Application in this proceeding seeks the Commission's permission to purchase the 1265 Bascom Avenue building. DRA Opening Brief at p. 12. The Commission knows that SJWC does not need

permission to purchase a building, and a quick read of SJWC's Application clearly shows that SJWC did not ask for any such permission. SJWC asked for permission only as required -- first, to sell the Main Office building under Section 851 of the Code; and second, to increase rates to reflect the costs associated with implementing Alternative 2, the least cost real estate option.

And SJWC has not violated the Commission's realm of authority. SJWC has not sold the Main Office building. Adobe is under contract to buy the building, but knows that SJWC first needs Commission approval to sell the building. So, SJWC and Adobe await the outcome of this Application. Nor has SJWC raised rates to its customers. SJWC has submitted a complete evidentiary record supporting its choice to implement Alternative 2, and documenting all of the costs of that Alternative.

DRA argues that SJWC misled the Commission by not informing the Commission and parties that it purchased 1265 Bascom in May 2007. To be clear, DRA does not argue that SJWC ever stated anything to the contrary. Indeed, SJWC Application and supporting direct testimony directly states that SJWC will purchase 1265 Bascom, and SJWC seeks new rates to reflect adding the \$4.3 million purchase price into SJWC's rate base. See SJWC-1, Jensen at p. 3: "Purchase and renovation costs for 1265 South Bascom Avenue. . . ."

One manner in which DRA errs in its allegations is thinking that SJWC's Application in this case sought DRA's and the Commission's advice as to how to solve its office space problem. But that is SJWC's business to resolve, not the Commission's. The Commission has often stated that it does not get involved in the day to day decision making of utilities it regulates. SJWC addressed its office space problem, analyzed the issue, reasoned through likely scenarios to address the problem, and then analyzed the costs of each scenario in order to choose the least cost option. SJWC presented to the Commission the end result of its analysis, for a reasonableness review. If the Commission agrees that SJWC has made a reasonable choice in implementing Alternative 2, then the Commission will grant SJWC authority to sell the Main Office and to implement the new rates it seeks.

There is absolutely no merit to DRA's inflammatory charge that SJWC has violated its ethical duties to the Commission. DRA's argument in this regard should be disregarded.

V. SJWC DID NOT VIOLATE SECTION 851 IN PRIOR LAND SALES.

In its Opening Brief, SJWC summarized the evidentiary record concerning DRA's allegation that SJWC had violated Section 851 with respect to certain prior land sales. SJWC will not repeat that argument here. But DRA's assertions are

without merit. DRA testified that it believes all land sales need section 851 approval, and that SJWC did not have the authority to determine that its property was no longer used or useful. But DRA is wrong about the law. And DRA is wrong about the facts pertaining to these parcels at issue. The evidence shows that these properties were moved out of rate base and into non-utility plant long before they were sold. SJWC satisfied the criteria of Section 851 and was allowed to dispose of its non-regulated property as it deemed appropriate.

VI. CONCLUSION

San Jose Water Company has presented the Commission with evidence to support a logical step-by-step analysis of its requests in this proceeding. The Commission should grant SJWC's Application in full.

Dated: February 5, 2008

Respectfully submitted,

Patricia A. Schmiede
Law Office of Patricia A. Schmiede

/s/ Patricia A. Schmiede

Patricia A. Schmiede
Attorney for Applicant
San Jose Water Company

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of “**SAN JOSE WATER COMPANY’s REPLY BRIEF TO THE OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES**” in A.07-01-035 by using the following service:

[X] **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses, as follows:

rs1@cpuc.ca.gov; bon@cpuc.ca.gov; sbh@cpuc.ca.gov; rkk@cpuc.ca.gov; flc@cpuc.ca.gov; smw@cpuc.ca.gov; palle_jensen@sjwater.com; pschmiede@schmiedelaw.com.

[X] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses, as follows: ALJ Richard Smith, California Public Utilities Commission, 505 Van Ness Avenue, San Francisco, CA 94102; Adrian Hanson, 1231 Forrestville Avenue, San Jose, CA 95510.

Executed on February 5, 2008, at San Rafael, California.

/s/ PATRICIA A. SCHMIEGE

Patricia A. Schmiede